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JAPANESE RESPONDENTS' REPLY TO DOMESTIC PRODUCER COMMENTS ON THE REMEDY RECOMMENDATION OF THE U.S. INTERNATIONAL TRADE COMMISSION FOR CARBON AND ALLOY FLAT-ROLLED STEEL PRODUCTS

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EXECUTIVE SUMMARY

Domestic producers disingenuously argue that only a 40 to 50 percent tariff remedy will facilitate their positive adjustment because quotas would not be immediately binding. By statute, the President cannot choose a remedy based on its short term effects, but rather must focus on its effectiveness over the full remedy period at facilitating positive adjustment to import competition. Quotas would not bind in the short term only because imports are at a six year low. This commercial reality and the fact that imports oversold domestic shipments in the first half of 2001 indicate that no import restraints are appropriate. Imports are not the industry's problem, so much as the systemic problems identified by the U.S. Government at the OECD steel talks in Paris, including inefficient excess domestic capacity. It is no coincidence that domestic producers were recently able to increase steel prices after LTV and Geneva idled around ten million tons of capacity.

The President should weigh remedy options not based upon their alleged short term benefits, but on their benefits over a multi-year remedy period, given projected demand growth and domestic capacity cuts. Japanese Respondents' economic analysis indicates that an anti-surge quota based on average import volume over the 1998-2000 period would deliver essentially the same benefits as a 20 percent tariff remedy with less damage to the overall economy, given the capacity cuts proposed by the U.S. Government in Paris, and steel demand growth projections by CRU International, Ltd. Both remedies would generate around $7 billion in additional revenues over a three-year remedy period, which would be sufficient to fund the industry's $4 to $7 billion adjustment plan. Anti-surge quotas would deliver equal or greater benefits as a tariff remedy when the impact of AD/CVD orders is taken into account, as they would prevent subject countries from filling their quota allocations.

Though quotas and tariffs deliver similar benefits, an anti-surge quota remedy would not preclude imports from the U.S. market as would a high tariff remedy, wreaking havoc on the overall economy. Import prices already exceed domestic prices. The ITC's economic analysis demonstrates that a high tariff remedy would largely cut off steel imports, by increasing domestic prices very little -- one to three percent -- but import prices a lot -- 12 to 17 percent -- pricing imports out of the market.

Domestic producers argue that tariffs would be cost-free because the cost of a large final consumer goods (like a refrigerator or finished automobile) would not increase by much. But the real cost of high tariff remedies would be borne by steel-consuming manufacturers producing intermediate goods, which employ 57 times as many workers as the steel industry. An economic study commissioned by the Consuming Industries Trade Action Coalition estimates that a 20.7 percent tariff would destroy a total of around 75,000 jobs in the overall economy, but preserve only 8,000 steel jobs.

Small and medium sized manufacturers would be especially hard hit, as they already face foreign competitors with access to much lower-priced steel, as domestic producers readily concede -- as much as 27 percent lower for hot-rolled steel, 17 percent lower for cold-rolled steel, and 43 percent lower for coated steel. Even a modest increase in steel prices for

these manufacturers would relinquish sales to their foreign competitors, especially in light of the strong dollar and the recession, costing jobs.

Further, these manufacturers would have to scramble to replace imports with new domestic suppliers or apply for exclusions -- a process that could take several months. In the highly competitive market for steel products, such a lengthy disruption in production would mean lost sales and financial ruination. The President must weigh this damage to the manufacturing economy against the meager short term benefits of a high tariff remedy.

Domestic manufacturers argue that a quota remedy would be impossible to administer, ignoring their proven track record in recent Section 201 remedies, such as Line Pipe and Lamb Meat, as well as in the steel voluntary restraint agreements ("VRAs") of the 1980s and early 1990s. As support, domestic producers contend that every specialized product would need its own quota, and that imports would surge in a race to fill global quotas. But no one, including Commissioner Okun, has proposed quota categories any more specific than hot-rolled steel, cold-rolled steel, plate, and coated steel -- the very categories used by the VRAs. Nor would there be a race to fill large global quotas if countries representing 70 to 80 percent of imports receive their own quota allocations. Finally, an efficient short supply mechanism would prevent shortages, as when demand patterns change.

Domestic producers attempt to inflate the perceived benefit of a high tariff remedy by asserting that anything less would devastate steel communities. Yet a high tariff remedy would devastate these same communities, and others, by costing many more jobs in steel consuming industries than they preserve in the steel industry. An anti-surge quota remedy would produce the same benefits while better balancing the interests of producers and consumers.

More fundamentally, the tone and substance of domestic producers' arguments demonstrate that they are more interested in protecting jobs and steel mills than in the positive adjustment required by law. The President should insist that the domestic industry confront the root problems that send it scrambling for import protection year in, year out. These problems, not imports, demonstrably account for the recent steel producer bankruptcies. As painful as restructuring may be, the President should condition any import restraints on the resolution of these problems, including enforceable, verifiable reductions in inefficient, excess domestic capacity.

INTRODUCTION

Domestic producers can only argue for a draconian 40 to 50 percent tariff remedy by slighting many of the key factors the President must consider when choosing an appropriate remedy, and ignoring the market changes other than import restrictions that are taking place. In light of these considerations, if any import restraint is imposed, a quota remedy strikes the best balance between facilitating positive adjustment and the precarious condition of steel consuming industries.

The President must choose a remedy that facilitates the industry's positive adjustment over the prospective remedy period. Domestic producers urge him to impose high tariffs because of their perceived short-term benefits. Yet the only reason a quota remedy would not deliver immediate short-term benefits is because import volumes are at six year lows. This reality and the fact that imports currently oversell domestic shipments demonstrate that no import restraints are appropriate; the root of the industry's problems lies elsewhere. Domestic producers argue that low import prices are the problem, yet observe that prices have begun to recover, probably due to the idling of inefficient excess domestic capacity. But if any remedy is imposed, a tariff remedy and a quota remedy would deliver similar price and revenue benefits over the medium term, as demand recovers and the industry restructures, but a quota would be far less disruptive to steel consuming industries.

The President must choose a remedy that best balances the social and economic costs and benefits. Domestic producers argue that the cost of high tariffs would be insignificant because the price of finished autos and refrigerators would go up little, and the cost of doing nothing would be the ruination of steel communities. But the real cost of a high tariff remedy would be borne by thousands of small and medium sized manufacturers which employ 57 times as many workers as the steel industry in many of the same communities. These companies already suffer from the recession, the strong dollar, and the highest steel prices in the world. A high tariff remedy would devastate these businesses by cutting off steel imports -- disrupting their established supplier relationships -- and placing them at an even greater cost disadvantage vis a vis foreign competitors during the recession. A quota would not be import-preclusive, and would strengthen steel prices during the economic recovery, projected for the second half, when purchasers will be less vulnerable. Whether a steel community survives or not, like the fate of individual steel mills, is dependant on industry structural factors unrelated to imports.

Finally, the President should insist that the domestic industry genuinely undertake a positive adjustment to import competition, though the tenor of the domestic industry's submission reflects their resolve to preserve as much capacity and employment as possible. At the OECD talks in Paris, the Administration acknowledged the systemic problems that make import protection an annual ritual for domestic steelmakers, including huge pension and health care liabilities and inefficient excess capacity. Any import restraints should be conditioned on concrete steps and binding commitments to resolve these problems.

I. QUOTAS WOULD ENABLE THE DOMESTIC INDUSTRY POSITIVELY TO ADJUST TO IMPORT COMPETITION OVER THE REMEDY PERIOD.

Domestic producers complain that a quota remedy would be ineffective "in the near term" because of the "severely depressed level of economic activity" and the fact that "2001 import volumes are lower than the average level of the past three years."[1] But reality argues for no Section 201 remedy at all -- import restraints are only appropriate where increased imports have caused serious injury.[2] Imports are now at six year lows, with finished flat-rolled steel imports in the first ten months of 2001 annualized at 26 percent below 1996 levels and 42 percent below the average level over the 1996-2000 period.

The true measure of a remedy's effectiveness must be the yardstick provided by statute: whether it facilitates the positive adjustment of the industry in the future with minimum harm to the rest of the economy.[3] To make this assessment, the remedy cannot be viewed in a vacuum, but in light of reasonable expectations regarding demand growth and the industry's rationalization of inefficient capacity during the remedy period,[4] as well as the interests of the overall economy. The domestic industry is once again advocating ephemeral quick fixes over lasting longer term solutions.

As demand recovers and domestic capacity is rationalized, the financial benefits of tariff and quota remedies converge. This occurs because a tariff remedy in this market has such small domestic price effects that it would generate additional revenues largely through increased volume more than increased prices. As demand strengths and domestic capacity is pared, quotas would begin to deliver the same boost to domestic sales volumes and revenues as tariffs, as quotas bind, and import sources face limits on their ability to increase to meet demand growth.

To account for demand growth and capacity cuts over time, Japanese respondents have adjusted their economic analysis to estimate the relative impact of an anti-surge remedy and a 20 percent tariff remedy ***over a three year remedy period***. By comparison, the economic analyses performed by the parties and the ITC heretofore have consisted of one year "snap-

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1 *Comments Regarding the Action the President Should Take Under Section 203(a) of the Trade Act of 1974 Filed on Behalf of Bethlehem Steel Corporation, LTV Steel Company, Inc., National Steel Corporation, and United States Steel Corporation*, Dewey Ballantine LLP and Skadden, Arps, Slate, Meagher & Flam LLP, January 4, 2002, at 6 ("Skadden/Dewey submission").

2 19 U.S.C. §2251(a) (remedy appropriate where "an article is being imported into the United States in such *increased quantities* as to be a substantial cause of injury").

3 19 U.S.C. §2251(a)(the President shall impose a remedy "which the President determines will facilitate efforts by the domestic industry to make a positive adjustment to import competition and provide greater economic and social benefits than costs").

4 The ITC itself compared the impact of different remedies conservatively assuming five percent demand growth and the permanent closure of certain domestic producers. *See* ITC Report, Additional Remedy Information - EC-051 (Dec. 7, 2001) (public version) ("ITC Memo 51").

shots" -- the projected price, volume, and revenue benefits ***in the first year*** import restraints are imposed.

By all accounts, the U.S. economy should begin to recover in the second half of 2002, and CRU International Ltd. conservatively projects that consumption of hot-rolled, cold-rolled, and galvanized steel consumption will grow at an average rate of over six percent during the 2002-2004 period.[5] Under this growth rate and a modest decline in domestic capacity,[6] a quota with a baseline predicated upon average imports over the most recent three year period for which data is available -- 1998-2000[7] -- would prevent future import surges, guaranteeing a strong price recovery and revenue growth as demand rebounds over the next three years.

Figure 1

Given the 12 percent reduction in domestic capacity already announced by the U.S. and projected demand growth, an anti-surge quota would deliver similar benefits as an import-preclusive 20 percent tariff over a three year remedy period.[8]

Remedy	6.4% Demand Growth		10% Demand Growth	
	Price Increase	Revenue Increase	Price Increase	Revenue Increase
20 percent tariff	6.3%	27.4%	8.2%	41.0%
Anti-surge quota	5.9%	24.1%	7.9%	38.7%

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5 This projected steel consumption growth rate reflects extremely depressed steel demand in 2001, which CRU projects will be 15 percent below 2000 levels for steel sheet products. The manufacturing economy has been in a sharp recession since August of 2000, when the NAPM Purchasing Managers Index fell below 50, indicating a contraction in manufacturing activity, where it has remained for 13 months. *See* NAPM website, <<www.napm.org>>. Industrial capacity utilization declined from 80.7 percent in November 2000 to 74.7 percent in November 2001 -- well below the 76.6 percent registered in the depths of the 1991 recession. See Federal Reserve website, <<www.federalreserve.gov>>.

6 The following analysis assumes a 12.1 percent decline in domestic capacity, which would be 15 million short tons, or squarely in the middle of the 13 to 17 million ton capacity cut discussed by the U.S. government at the OECD talks in Paris. This is in fact less than the 17 million tons of steel capacity shut down over the past two years, which may or may not be re-started, including flat-rolled steel producers LTV (7 million tons), Geneva Steel (2.5 million tons), Acme Steel (1.2 million tons), and Gulf States Steel (1.1 million tons). "Differing definitions on steel overcapacity," *American Metal Market*, Jan. 4, 2002.

7 The 1998-2000 quota baseline for the four finished flat-rolled steel products in the aggregate is 14,172,635 ST. *See* Japanese Respondents' Comments on the Remedy Recommendation of the U.S. International Trade Commission for Carbon and Alloy Flat-Rolled Steel Products, Jan. 4, 2002, at Exhibit 1.

8 Percentage price and revenue increases projected over three year period relative to 2000; a 24.1% revenue increase means that over the three year remedy period, additional revenues equal to 24.1% of 2000 revenue would be generated, as compared to no remedy, no demand growth, and no capacity rationalization. *See* Exhibit 2.

Using 2000 as the baseline, an anti-surge quota coupled with only 6.4 percent demand growth would provide $6.5 billion in additional revenues over a three year remedy period[9] -- enough to finance the $4 to $7 billion adjustment plan proposed by domestic producers. A higher 10 percent growth in demand provides even greater revenue.

Moreover, these quota benefits are vastly understated, because the continuation of AD/CVD orders will prevent many of the largest suppliers from even beginning to fill their quota allocations.[10] In other words, most of the countries receiving the largest quota allocations will not be able to use them, because recent AD/CVD orders have severely limited their ability to export plate and hot-rolled steel. As an alternative approach to estimating this effect,[11] Exhibit 1 demonstrates that AD/CVD orders on plate reduced imports from subject countries by an average of 79 percent, while AD/CVD orders on hot-rolled steel reduced imports from subject countries by 95 to 98 percent. If we calculate the economic effects based on the lower quantities to reflect the actual portion they are likely to fill in light of AD/CVD orders[12] -- as well as the suspension agreement on Russian imports[13] -- quotas based on the 1998-2000 baseline produce even more generous price and revenue effects.[14]

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9 Given finished flat-rolled steel revenues of $26.8 billion in 2000. *Steel*, Inv. No. TA-201-73, USITC Pub. 3479 (Dec. 2001), Volume II at FLAT-17-19, 21 ("ITC Report").

10 Japanese respondents maintain that AD/CVD orders should be revoked if any import restraints are imposed.

11 The January 4 submission by Japanese respondents estimated the effect of AD/CVD orders on a quota remedy based on 1998-2000 by assuming that top ten supplier countries subject to AD/CVD margins of 20 percent or higher would not use their quota allocation. This second approach is more conservative, in that it recognizes that countries subject to even high AD/CVD duties may continue to export at low levels.

12 Note we are <u>not</u> suggesting that quotas be set at these low levels that would improperly discriminate against sources not subject to such market preclusive orders.

13 Russian hot-rolled steel imports are limited to 744,048 ST in 2002 and 799,162 ST in 2003.

14 Note that Japanese respondents are not advocating quotas based upon the 1998-2000 period adjusted for the impact of AD/CVD orders -- such a baseline would be unlawful as not based on a recent, representative three year period. Rather, we only stress that AD/CVD orders would reduce the actual level of imports possible under a quota baseline predicated on the 1998-2000 period. Reducing the allocations of top ten supplier countries subject to AD/CVD orders on hot-rolled by 97% and on plate by 75%, and limiting Russia's allocation to 744,048 ST as per the suspension agreement, the effective hot-rolled steel baseline quota becomes 5,362,045 ST, and the effective plate baseline quota becomes 649,584 ST. In the aggregate, the quota becomes 11,079,672 ST.

Figure 2

The benefits of an anti-surge quota remedy are enhanced when AD/CVD orders are taken into account.[15]

Remedy	6.4% Demand Growth		10% Demand Growth	
	Price Increase	Revenue Increase	Price Increase	Revenue Increase
20% Tariff	6.3%	27.4%	8.2%	41.0%
Anti-surge quota	6.2%	26.5%	8.2%	41.2%

The total revenue benefit of anti-surge quotas over a three year remedy period swells to between $7.1 billion and $11.0 billion. These benefits to the domestic industries are almost the same as under a 20 percent tariff, but without the disruption of a tariff remedy that would devastate companies that must use imports.

The ITC Office of Economics reached similar conclusions with its own COMPAS analysis, but using a quota based on 1996-1997 import market share applied to domestic steel consumption during the 2H00-1H01 period -- which is roughly equivalent to 1998-2000 quotas adjusted for the impact of AD/CVD orders.[16]

Figure 3

The ITC's COMPAS analysis confirms that a quota remedy coupled with demand growth would deliver the same benefits as a high tariff remedy[17]

	Annual Price Increase	Annual Revenue Increase
20% Tariff	0.2-1.3	3.3-8.3
Quota with 5% growth	0.7-2.0	8.8-11.8
Quota with 10% growth	1.6-3.7	14.5-18.9

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15 Percentage increases over a three year remedy period relative to 2000. *See* Exhibit 2.

16 Applying the average import market share over the 1996-1997 period to U.S. consumption in the 2H00-1H01 period results in a quota baseline of 1,360,006 ST for plate, 5,107,068 ST for hot-rolled, 2,917,445 ST for cold-rolled, and 1,829,825 ST for coated. Calculated using ITC Report, Vol. II at FLAT-61-63.

17 ITC Memo 51, at FLAT-12-13; ITC Report, Remedy Memorandum - EC-Y-048 (Oct. 21, 2001)(public version), at FLAT-27 ("ITC Memo 48").

This quota, coupled with 5 percent demand growth, would result in additional revenues of between $7.2 billion and $9.6 billion over a three year remedy period[18] -- again, more than enough to fund the industry's adjustment plans. The ITC's COMPAS analysis of this quota remedy coupled with a modest cut in domestic capacity, but no demand growth, yielded similar financial benefits, though the specific results are confidential.[19]

II. QUOTAS WOULD BE SIMPLE TO ADMINISTER

Domestic producers argue that a quota remedy would be unworkable by creating a strawman: quotas with an extreme level of specificity no one advocates. They argue that quotas for each flat-rolled steel product -- plate, hot-rolled, cold-rolled, and coated steel -- are not good enough, but that each and every specialized product within each product would have to receive its own quota.[20] They further argue that quotas would have to be adjusted regularly for changes in demand patterns.[21]

Domestic producers are alone in proposing quotas of such complexity. Both Japanese respondents and Commissioner Okun have proposed quotas at the finished flat-rolled steel product level, delineating plate, hot-rolled steel, cold-rolled steel, and coated steel. These are the very categories with which the U.S. Department of Commerce gained experience through the voluntary restraint agreements of the 1980s ("VRAs"). Respondents' proposed short supply mechanism would deal with changes in demand patterns that result in shortages. Changes that do not result in shortages need not be addressed.

The more simplified the quota remedy, the more beneficial to the industry. Broader quota categories encourage exporters to maximize their revenues by filling their quotas with the highest-prices products first, lifting average import prices. By not adjusting quotas to account for changing demand patterns -- except when such changes cause shortages -- the quotas covering products with the strongest demand growth become more restrictive.

Domestic producers also argue that quotas would trigger import surges at the beginning of each quarter, as exporters race to fill global quotas.[22] Respondents have already recognized and addressed this potential problem, and have proposed that quotas be allocated to

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18 Given 2000 revenues from U.S. commercial shipments of $26.8 billion, and multiplying the annual benefit by three.

19 ITC Memo-51, at FLAT-35.

20 Dewey/Skadden submission, at 14-15 (For example, "the hot-dipped galvanized category would have to be divided into such products as zinc-coated, galvalume, and galvanealed, because these different products are not exported by all countries.").

21 *Id*. at 15.

22 *Id*. at 14.

supplier countries representing 70 to 80 percent of import volume, to minimize the size of residual global quotas. If all major suppliers have their own quota allocations, there can be no race to fill global quotas.

Domestic producer complaints over the feasibility of a quota remedy ultimately ignore their successful 30 year track record. The U.S. Department of Commerce has ample experience with administering quotas successfully, from the steel VRAs, to the Multi-Fiber Arrangement quotas (now under the WTO Agreement on Textile and Clothing) on textile and apparel imports, to quotas on Japanese auto imports in the 1980s, to a myriad of recent safeguard measures on wheat gluten, lamb meat, wire rod, and line pipe.

III. IMPORT QUANTITIES, NOT PRICES, ARE THE POTENTIAL PROBLEM, MAKING ANTI-SURGE QUOTAS THE BEST SOLUTION

Domestic producers argue that although import volumes are currently low, import prices are the problem, calling for a price-oriented tariff remedy. This argument represents a strange reversal of everything that domestic producers said during the ITC's injury and remedy investigations, as summarized in Exhibit 3. Domestic producers repeatedly alleged that import "surges" in 1998, and to a lesser extent 2000, caused their distress. Schagrin Associates, in its submission to the USTR, devotes an entire appendix to the increase in import volume ***between 1996 and 1998***, alluding to the slight increase between 1996 and 2000 as an afterthought.[23] The Commission agreed that the high level of imports in 1998 -- not 2000 or 2001 -- represents the main causal link between import volume and injury.[24] By statute, the injury had to have been inflicted by increased imports. It must be news to the ITC that import prices, not volumes are the problem.

It is particularly unlikely that import prices are currently the problem when imports ***oversold*** domestic shipments in the first half of 2001.

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[23] *Public Comments on Potential Action Under Section 203 of the Trade Act of 1974 With Regard to Steel*, Schagrin Associates, January 4, 2002, appendix at 28-29 (begins "Imports of carbon and alloy steel flat products increased from 18,851,160 tons in 1996 to 25,822,437 tons in 1998, an increase of 36.98 percent.") ("Schagrin submission").

[24] ITC Report at 63-64, 66.

Figure 4

Imports Oversold Domestic Shipments in the First Half of 2001[25]

Product	Domestic AUV	Import AUV	Price Gap	Overselling Margin
Plate	$379	$421	$42	11.1%
Hot-rolled steel	$253	$270	$17	4.5%
Cold-rolled steel	$381	$399	$18	4.7%
Coated	$509	$515	$6	1.2%

Domestic producers attempt to obfuscate higher import prices in the U.S. market by citing offers allegedly made by foreign producers to foreign customers -- for example, offers by Russian and Ukrainian producers to customers in East Asia[26] -- or single alleged lowball offers by Russian producers in the United States.[27] These anecdotal "offers" about a few selected countries say nothing about U.S. import prices; they are selective, of dubious credibility, and in the case of offers to foreign customers, do not take into account transportation and other costs associated with exporting to the U.S. market. Moreover, Russian and Ukrainian steel is of an extremely low quality,[28] and Russian import quantities are strictly limited by a suspension agreement.[29] The President should rely on the ***actual*** import average unit values in the ITC's staff report, which are $6 to $42 per ton ***higher*** than domestic producer average unit values.

Domestic producers do not stop to consider the contradiction between their assertion that import prices are the problem,[30] and their observation that U.S. steel prices have

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25 Staff Report at FLAT-12-14, 16, 21-23, 25. Units are dollar per ton. Figure excludes imports from Canada.

26 Schagrin submission, at 16; Dewey/Ballantine submission at 6, Exhibit 2.

27 Skadden/Dewey submission, at 6-7 (citing an alleged offer by Severstal).

28 *See, e.g. Certain Hot-Rolled Steel Products from Japan*, Inv. No. 731-TA-807(Final), USITC Pub. 3202 (June 1999), at II-8 ("Importers named a large number of factors which differentiate Russian certain hot-rolled steel products from domestic and other subject imported products...Russian products do not always meet ASTM requirements; have {chemical impurities} which negatively affects ductility and welding integrity...; have problems in terms of gage tolerance, width tolerance, and chemistry; and may have problems with packaging and transportation damage.").

29 *See* U.S. Department of Commerce press release, "Commerce Secretary William Daley Announces Agreements Sharply Reducing Imports of Russian Steel," July 13, 1999.

30 Schagrin submission, at 2 ("A forty percent tariff is essential because steel purchasers continue to use ever lower import prices to drive already low U.S. market prices down to the world price level for the inputs they purchase.").

already begun to recover.[31] This could not have resulted from the market's anticipation of Section 201 relief, as they contend, because imports remain in the U.S. market, and remained fairly steady between the first half of 2001 and the third quarter of 2001.[32] Low import volumes and relatively high import prices have certainly not prevented a price recovery, but the most important factor has been the idling of substantial domestic capacity, including LTV and Geneva Steel that together accounted for over 10 million tons of raw steel production in 2000.[33]

As steel demand rebounds and the domestic industry restructures, steel prices will continue to recover, making the real threat to the industry's positive adjustment a future import surge. Domestic producers duly note that U.S. steel prices, though depressed, are still the highest in the world,[34] and if this differential were to widen, the incentive to export to the U.S. market will grow stronger. Anti-surge quotas would prevent imports from gaining more than a predicable share of the U.S. market during the recovery, guaranteeing domestic producers the aforementioned increases in prices and revenues.

At the same time, this more reasoned and balanced Section 201 remedy would increase the likelihood that the OECD talks will succeed in reducing global steel overcapacity. A high tariff remedy would not force the closure of excess capacity, as domestic producers contend, but cause the OECD talks to break down. No country has supported a tariff remedy before the ITC or the USTR. They are the most inflammatory policy option, and would tie the administration's hands at the OECD negotiations, providing no flexibility for compromise. Import-preclusive tariffs would also trigger a protectionist spiral, as countries scramble to protect their own domestic producers from imports displaced from the U.S. market.[35] Excess capacity would be preserved, not cut.

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31 *Id.* at 17 ("Yet just the prospect of relief has led to domestic industry efforts to stop the decline in U.S. market prices and institute price increases in early 2002 notwithstanding continued weak demand.").

32 Subject plate imports (excluding Canada) were 281,012 ST in 1H01 and 205,619 ST in 3Q01; hot-rolled steel imports were 1,521,532 ST in 1H01 and 457,546 ST in 3Q01; cold-rolled steel imports were 1,318,390 ST in 1H01 and 710,393 ST in 3Q01; galvanized steel imports were 720,130 ST in 1H01 and 343,804 ST in 3Q01. Department of Commerce, Bureau of Import Statistics.

33 *See* "U.S. Steel Mills lift key domestic prices," *The Wall Street Journal*, Jan. 10, 2002 ("Prices for hot-rolled steel ... have jumped 15% in the past 60 days … Imports have been on the decline for months due in part to the softening economy and prohibitively low steel prices … Aside from the import drop, American steelmakers are finding new demand because of the demise of LTV Corp., the country's fourth-largest steelmaker."); s*ee also* ITC Report at 360 (LTV and Geneva Steel have recently shut down operations); *Metal Statistics 2001*, at 311 (LTV and Geneva raw steel production in 2000 was 10,123,000 ST.).

34 Schagrin submission, at 14-15 ("...{CITAC} members and other purchasers seek to drive the U.S. market price down to world price levels.").

35 *See* "Steelmakers look to protect their home markets," Metal Bulletin, December 31, 2001 ("Concerned that U.S. market restrictions could divert up to 15m tpy of steel into Latin American markets next year, several governments started to raise import tariffs in a move to protect their local industries."); see also "Fears of trade war with U.S. over steel," *The London Times*, December 14, 2001 (Pascal Lamy, EU Trade Commissioner, announced the resumption of import monitoring to quickly initiate safeguard investigations to protect European steel producers, if necessary.).

Indeed, domestic producers complain that quotas are a bad choice of remedy because they grant foreign producers quota rents,[36] but these rents are actually a plus. First, quota rents align the interests of domestic and foreign steelmakers in raising U.S. steel prices. Foreign producers have every incentive to fill their quotas with the highest-priced products -- quota rents are only realized when prices go up. Second, quota rents help placate foreign opposition to Section 201 import restraints, increasing the likelihood of OECD-negotiated capacity cuts.

IV. QUOTAS STRIKE THE BEST BALANCE BETWEEN CONSUMER AND PRODUCER INTERESTS

The President is charged with imposing a remedy that will facilitate the industry's positive adjustment to import competition "and provide greater economic and social benefits than costs."[37] Domestic producers disingenuously downplay the cost of a high tariff remedy to the rest of the economy by limiting their analysis to the cost of refrigerators and finished automobiles[38] -- two products with a relatively small steel content.

The real cost of high tariffs will primarily be borne by the thousands of small- and medium-sized manufacturers making products that are steel intensive -- such as auto parts stamped or formed out of steel. These companies are already suffering mightily from the strong dollar and the recession. They must compete against foreign manufacturers that already enjoy access to lower priced steel. Domestic producers readily admit that U.S. steel prices are currently the highest in the world,[39] and no one is more keenly aware of this fact than steel-intensive manufacturers. To them, domestic producers offer the assurance that import prices will go up "less than 24 percent."[40] Domestic producers also reassure manufacturers that even with a high tariff remedy, steel prices would remain near 20 year lows,[41] but this makes no difference when the steel consumed by their foreign competitors is priced even lower.

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36 Skadden/Dewey submission, at 10.

37 19 U.S.C. §2253(a)(1)(A).

38 Skadden/Dewey submission, at 26.

39 Schagrin submission, at 14-15 ("...CITAC and other purchasers seek to drive U.S. prices down to world price levels.").

40 Dewey/Schagrin submission, at 25.

41 *Id*. at 27.

Figure 5

U.S. Steel Prices[42] Are Already The Highest In the World[43]

	U.S.	China	Latin America	W.Europe	Japan[44]
Hot-rolled coil	$240	$198-$204	$176-$198	$209-$220	$241
Cold-rolled coil	$320	$265-$270	$265-$287	$276-$309	$308
Electro-galvanized coils	$580	$331-$353	$364-$408	$342-$441	$466

Steel-intensive U.S. manufacturers are already at a tremendous cost disadvantage vis a vis their foreign competitors, and could not bear a significant increase in steel prices relative to world prices. Steel may represent only three percent of the cost of producing an automobile or refrigerator,[45] but represents "the single largest element of cost" for many more steel-intensive industries.[46] At the ITC's remedy hearing, representatives of numerous such manufacturers testified that ***any*** increase in steel prices confined to the United States would cede their foreign competitors an unbeatable cost advantage, forcing layoffs.[47]

These metal consuming industries employ 57 times as many workers as the steel industry and metal stampers alone -- the most steel-intensive manufacturers -- employ twice as

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42 In dollars per short ton. U.S. prices from *American Metal Market*, Jan. 8, 2002, <<www.amm.com/subscrib/prices/shet.htm>> (converted from hundredweight to short tons); World prices from *Metal Bulletin*, Dec. 31, 2001, at 20 (converted from metric tons to short tons).

43 These disparities in world steel prices alone should convince even an ardent supporters of the dumping laws that the U.S. Department of Commerce finds dumping in every steel case because of how the Department of Commerce calculates dumping margins and conducts its antidumping investigations. This is precisely why every other country in the world insisted that antidumping rules be on the Doha WTO agenda.

44 *Japan Metal Bulletin*, Jan. 11, 2001, <<www.japanmetalbulletin.com/data-is/is-index.html>> (Osaka)(given exchange rate of 132.4 yen per dollar on Jan. 11, 2001, converted from metric tons to short tons).

45 *See* Skadden/Dewey submission, at Exhibit 3 (assuming that the cost of producing an average refrigerator is around $500.).

46 *See* ITC Remedy Tr. at 279 (Mr. Suter, retired vice chairman and COO, Emerson Electric)(for parts manufacturers like Emerson Electric, steel is "in many cases...the largest single element of cost.); at 282 (Mr. Sopko, Stamco Industries)(metal stampers "rely on steel as our major input.").

47 *See* Exhibit 4 for a compendium of this testimony.

many workers.[48] An econometric study commissioned by the Consuming Industries Trade Action Coalition ("CITAC") concluded that a 20.7 percent tariff would increase steel prices only 0.4 percent, but result in 30,592 layoffs at steel-consuming businesses, and another 43,910 layoffs elsewhere in the economy.[49] Small increases in steel prices matter a great deal to these companies.

Ironically, high tariffs that increase prices marginally in the short run could harm the steel industry in the long run, by forcing steel-intensive manufacturers out of business or abroad, permanently reducing U.S. steel consumption. This shift offshore occurred when antidumping duties were slapped on flat-panel display imports, placing domestic laptop manufacturers at a huge disadvantage vis a vis foreign competitors. By the time duties were revoked, most domestic laptop manufacturers had moved abroad, and the domestic market for flat-panel displays had been decimated.[50]

High tariffs would be doubly disruptive to U.S. manufacturers by precluding most imports from the U.S. market, forcing manufacturers dependant on imports to scramble for domestic suppliers or apply for product exclusions. Smaller manufacturers would be particularly vulnerable to this supply disruption, as most depend on service centers stocked with imported steel and willing to satisfy smaller orders. Given these low volume requirements, these manufacturers would either have to purchase steel directly from domestic producers at much higher prices, or wait for service centers to increase their stock of domestic steel, all the while losing customers.

The fact that large volume customers may not suffer much of a domestic price increase does not help smaller volume customers who could face stiff price increases on smaller volumes of specialized orders. Indeed, as demand for commodity grade steel that can justify large volume runs improves, domestic steelmakers will be even less interested in disrupting their high volume production to meet these specialized orders.

Whether small or large, many purchasers require steel products "with a rigid set of chemical and physical characteristics"[51] and have a lengthy certification or qualification process for new suppliers,[52] making it impossible to instantaneously switch from a qualified

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48 ITC Remedy Tr. at 277 (Mr. Jenson, CITAC), 282 (Mr. Zawacki, GR Spring & Stamping).

49 Joseph F. Francois and Laura Baughman, "Estimated Economic Effects of Proposed Import Relief Remedies for Steel," prepared for CITAC, Dec. 19, 2001, at 9-10.

50 *See* Jim Fuller, "Report says trade policies hamper U.S. competitiveness," USAI, June 9, 1993 (Council on Competitiveness report concluded that antidumping duties on flat panel displays did more harm than good by forcing some laptop computer production abroad.).

51 *See Certain hot-rolled steel products from Japan*, Inv. No. 731-TA-807(Final), USITC Pub. 3202 (June 1999), at II-7 (80 percent of hot-rolled steel purchasers have certification or qualification programs for new suppliers)("Hot-rolled steel").

52 *Id*.; s*ee also Certain cut-to-length steel plate from France, India, Indonesia, Italy, Japan, and Korea*, Inv. Nos. 701-TA-387-391(Final) and 731-TA-816-821 (Final), USITC Pub. 3273 (Jan. 2000), at II-11("U.S. producers and importers were asked if their customers had certification programs or qualification

foreign supplier to an unqualified domestic supplier. Qualifying a new supplier can take anywhere from one month to a year for hot-rolled steel.[53] For manufacturers dependant on foreign suppliers cut off by a high tariff remedy, this delay would mean forfeiting a large amount of business.

Although the COMPAS model and other economic models predict that 20 to 40 percent tariffs would reduce import volumes from 20 to 65 percent,[54] this conservative conclusion does not make any intuitive sense. For example, domestic producers' COMPAS analysis indicates that their proposed 40 to 50 percent tariff remedy would increase domestic prices 6.75 to 8.90 percent, increase import prices "less than 24 percent", and reduce import volume 65.55 percent. Assuming that import prices are now at parity with domestic prices -- they are in fact higher -- this remedy would send import prices soaring 15.10 to 17.25 percent higher than domestic prices. The aforementioned downstream manufacturers struggling against foreign competitors with access to lower steel prices would be insane to purchase imported steel at this premium over domestic steel. Little imported steel could be sold at this premium, and import volume would fall far more than 65.55 percent, until what few imports remained were priced competitively.[55]

The ITC's own COMPAS analysis predicts that a 20 percent tariff would increase U.S. prices only 0.3 to 3.1 percent, but import prices 11.6 to 16.6 percent, depending on the flat-rolled steel product.[56] Again assuming price parity, this remedy would send import prices 11.3 to 13.5 percent above domestic prices. The ITC's COMPAS analysis predicts that import volume would decline only 22.4 to 49.7 percent, but again this makes no intuitive sense. Import volume will decline until import overselling disappears -- reducing imports close to zero.

V. FOR ITS HIGH COST TO THE ECONOMY, A TARIFF REMEDY WOULD DELIVER SCANT BENEFITS TO THE DOMESTIC STEEL INDUSTRY

Domestic producers argue that high tariffs are the solution to low prices, but the price impact of even the highest tariff recommendation made by a minority of Commissioners would be inconsequential for domestic producers. The ITC's COMPAS analysis indicates that a 20 percent tariff would increase prices for all finished flat-rolled steel products (including tin

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requirements that must be met in order to sell to them. Eleven out of 17 responding U.S. producers replied in the affirmative, and 22 out of 34 responding importers replied in the affirmative.").

53 Hot-rolled steel, at II-7.

54 Japanese respondents' own COMPAS analysis concludes that only half of the decline in import volume would be replaced by an increase domestic shipments, suggesting that high tariffs would cause an absolute decline in U.S. steel consumption.

55 And the domestic producers' COMPAS model exaggerates the price impact of high tariffs by assuming falsely that all domestic producers use imported steel as inputs in the production of finished flat-rolled steel products (thus forcing domestic producers to raise their prices as the cost of their imported steel inputs goes up).

56 ITC Memo 48, at FLAT-22-25 (import prices are for non-NAFTA countries.).

mill products) 0.2 to 1.3 percent and revenues 3.3 to 8.3 percent.[57] Even a 40 percent tariff would increase prices only 0.3 to 2.2 percent and revenues 5.9 to 13.4 percent.[58] Low domestic capacity utilization and slack demand would prevent high tariffs from having much of an effect on prices.

These meager price and revenue effects would do little to preserve steel industry jobs. The CITAC econometric study -- based on a widely used, broad-based general equilibrium model -- concluded that a 20.7 percent tariff on all steel products for which the ITC rendered an affirmative injury determination would preserve only 8,902 jobs in an industry with 218,500 jobs in 2000.[59]

Moreover, as steel demand and prices recover with the economy, an uniform high tariff remedy would encourage product and country shifting, undermining its financial benefits. The lowest-cost producers, such as China and India, would be in the best position to absorb tariffs and still price their products competitively. Domestic producers complain of country shifting resulting from AD/CVD orders,[60] but advocate a tariff remedy that exacerbates the problem. Under a quota, no country can increase its exports faster than any other without filling its quota allocation (or the residual global quota) faster. The financial benefits of a quota remedy would grow with the economy, as quotas become binding and all demand growth accrues to domestic producers.

Perhaps because the price and revenue effects of a tariff remedy are so paltry, domestic producers attempt to inflate the perceived benefits of a tariff remedy with speculation on the cost of doing nothing, stressing the economic dependence of numerous communities on steel manufacturing. The President must bear in mind that regardless of the remedy he chooses, the domestic steel industry must make a positive adjustment to import competition. At the OECD meeting in Paris, the Administration demonstrated its understanding of the systemic problems facing the industry having nothing to do with imports: crushing legacy costs, the ascendance of more efficient minimills, small furnace size, and the prevalence of inefficient producers desperate to sell steel at any price. Solving these problems will not be painless, and blaming imports will not solve these problems.

Indeed, most of the bankruptcies domestic producers continually trumpet as evidence of the import problem had nothing to do with import competition, but with these more fundamental problems afflicting the industry. Indeed, Nucor has argued that the main problem

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57 ITC Memo 48, at FLAT-27.

58 *Id*. at FLAT-28.

59 CITAC study at 10.

60 Schagrin submission, at 28 ("Imports declined after the imposition of Hot-rolled relief and surged from new source countries leading to a second imposition of Title VII relief.").

with bankrupt domestic producers is that they have not stayed out of business, with "old inefficient" or "worn out" facilities using Chapter 11 bankruptcy to "limp from crisis to crisis."[61]

Figure 6

Domestic Flat-Rolled Steel Producer Bankruptcies Had Nothing To Do With Imports[62]

Company	Reason for Bankruptcy
Acme Steel	Failed attempt to create world's first "mini-grated" mill, coupling integrated steelmaking with minimill rolling facility; continual mechanical and quality problems alienated demanding customers.
Bethlehem Steel	Observers cite huge legacy costs as the major contributor to bankruptcy.[63]
Geneva Steel	Unfavorable credit arrangements; poor management; ill-conceived location in mountains far from ports and customers.
Gulf States Steel	High interest junk bond financing; antiquated equipment; two new minimill competitors in the immediate area.
Heartland Steel	Delays in the start-up of this new facility forced additional borrowing and default.
LTV	Series of acquisitions and investments went awry, including major investment in Trico.
Trico Steel	New minimill used untested, defective design, creating unending production problems; two of three transformers down for ten months, halving capacity.
Wheeling-Pittsburgh	Never recovered from ten month strike in 1996-1997 that restored costly defined benefits pension plan, which chairman predicted would bankrupt the company.

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61 Nucor submission to U.S. Department of Commerce, "Steel Industry Renewal, Policies Needed," August 15, 2001, at 3 (urges limits on relief under bankruptcy laws, which harm competitive producers), 4 ("old inefficient mills...limp from crisis to crisis and usually end up in Chapter 11 here...{s}uch companies should be permanently closed... .").

62 *See* Exhibit 5 for a complete discussion, with citations.

63 *See* "Bethlehem may not star in industry reshuffle," American Metal Market, October 16, 2001 (Peter Marcus, World Steel Dynamics: "As long as you have sizeable legacy costs, you're not going to be a player."; Charles Bradford, Bradford Research: "No one will touch them in a consolidation" given $2 billion in pension and health care liabilities.); "Steelmakers woes are tied to legacy costs," American Metal Market, October 12, 2001 ("Key steel advocates on Capitol Hill responded quickly to the news that Bethlehem Steel Corp. had filed for Chapter 11 bankruptcy protection Monday morning, citing legacy costs as a top reason for the steelmaker's financial woes and marshalling legislative measures to devise an immediate solution," $3 billion in pension and health care liabilities with 14,000 employees supporting 74,000 pensioners.).

Domestic producers use the preservation of steel mills and jobs to make an emotional appeal for high tariffs,[64] when the President's remedy should focus on addressing the root causes of the industry's perennial quest for import protection. Of the adjustment plans submitted to the ITC, the vast majority would increase domestic capacity and few would reduce capacity.[65] Yet many bankrupt producers cannot be made globally competitive, due to location or extensive production inefficiencies, and the OECD negotiations on reducing global overcapacity are aimed at such facilities. The President should condition any import restraints he imposes on domestic capacity reduction targets, with restraints removed if the ITC determines that the targets are unmet during an interim review.

Finally, the President must consider that preserving jobs at inefficient steel mills by imposing an import-preclusive tariff remedy would cost far more jobs in communities elsewhere. Steel-consuming manufacturers employ around 57 times as many workers as the steel industry[66] -- 12.8 million jobs.[67] Metal formers alone -- the companies that would be most negatively impacted by a high tariff remedy -- employ twice as many workers as the steel industry.[68] These manufacturers are already suffering from the recession and the strong dollar, and would only shed more jobs if tariffs widened the steel cost advantage already enjoyed by their foreign competitors. An anti-surge quota would facilitate the steel industry's positive adjustment as the economy recovers without devastating the communities dependant on steel consuming factories during the recession.

VI. REGARDLESS OF WHAT KIND OF RELIEF IS IMPOSED, CERTAIN PRODUCT EXCLUSIONS MUST BE GRANTED

If any import remedy is imposed, the Administration should exclude from its restrictions all products not made domestically, or made domestically in insufficient quantities or quality. Exclusion requests have been submitted for a variety of specialty products from Japan. Past safeguards cases demonstrate that all such products, which could not have contributed to any serious injury to the domestic steel industry, should not be subject to any remedy. The following discussion highlights many of the most troublesome product exclusions, but is by no means an exhaustive discussion of all product exclusions.

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64 Dewey/Skadden submission, at 33 ("If domestic steel companies are shut down and forced into liquidation -- several have already been shut down while others will be in the near future if adequate relief is not granted -- the short-term and long-term economic and social costs will be huge... .").

65 Based on confidential adjustment plans analyzed in the Japanese Respondents' Posthearing Remedy Brief, Nov. 13, 2001, at Exhibit 8.

66 ITC Remedy Tr. at 277 (Mr. Jenson, CITAC).

67 CITAC press release, "Consumers to ITC: 'Steel Import Restrictions Steal Jobs'", Nov. 6, 2001, <<http://www.citac-trade.org/latest/release_06_11_2001.htm>>.

68 *Id*. at 282 (Mr. Zawacki, GR Spring & Stamping).

For some of these products, the domestic mills have indicated that they do not oppose the exclusion on the condition that no other mills make the product, including:[69]

- Hot-rolled TRIP steel (X-061.9)
- Cold-rolled steel for battery jackets (X-142.20)
- Coated steel sheet for heat-shrinkable bands (X-142.10)
- Tin free steel for inner magnetic steel
- Ultra wide tin free steel (X-061.1)
- Electrolytically tin-coated steel (variety two) (X-061.13-2, X-039, X-075)

Assuming no opposition arises to these exclusion requests, the Administration should grant them, and exclude all other products the domestic industry has shown no interest in restricting. For other contested exclusion requests, we have responded to the domestic industry's claims that the product definitions were too broad, covering product that may be available domestically. We will work with the domestic industry to reach an agreement on these revised definitions.

However, while domestic industry consensus to exclude a particular product may be an important factor in deciding which products to exclude, such opposition alone is not a sufficient basis for the President to reject an exclusion request. Consider the following examples:

- Laminated tin-free steel (X-061.3, X-075.3) – The injury vote was a tie for tin mill products. Of the three Commissioners that voted affirmatively, Commissioners Devaney and Miller recommended exclusion of this product. Therefore, five of the six Commissioners agree that no remedy should be imposed on this product. Moreover, the only domestic producer that claims the ability to producer this product -- Weirton Steel -- was unable to fill a customer's order for a sample shipment of the product placed in response to the Section 201 investigation.

- Hot-rolled dual-phase carbon steel sheet (X-011) – Honda of America submitted this exclusion request, explaining that this product is not commercially available in the United States. U.S. Steel submitted a letter indicating that it does not oppose the request, though it alleges that a similar product is under development. Nor does Bethlehem Steel oppose the request, despite unconfirmed rumors that it may be able to produce a similar product. Only National Steel has expressed opposition, though they admit to never having tried to produce dual-phase hot-rolled steel, and therefore have no grounds to claim the capability to produce the product. The Administration should grant this exclusion in deference to U.S. Steel and Bethlehem Steel -- the only producers with any possible reason for opposing it -- and disregard the opposition of National Steel, which has no legitimate interest in the product.

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[69] For two of these products -- cold-rolled steel for battery jackets and coated steel sheet for heat-shrinkable bands -- we were informed by counsel to the U.S. integrated mills that they would formally withdraw their opposition in a submission to the USTR this week.

- Non-oriented, high silicon, magnetic steel sheet (X-142.21) – AK Steel, a domestic producer of non-oriented electrical steel, does not oppose this request. Moreover, Schagrin Associates, which represents WCI Steel among other U.S. mills, stated that his clients do not oppose this request. However, the integrated mills oppose because they "believe" that WCI can produce this product. If WCI itself does not oppose the request, the Administration should assume that the domestic industry agrees to exclude this product.

- Electro-Galvanized Alloy Steel (x - 142.11) – A similar situation rose with this exclusion request. Schagrin's clients do not object, but certain integrated mills oppose the request, claiming that WCI and Wheeling-Pitt can make the product. However, WCI itself does not oppose and Wheeling-Pitt has not stated its position on any requests. WCI and Wheeling-Pitt are capable of speaking for themselves. The TPSC therefore should disregard the opposition of other integrated mills.

We note that the domestic producers often claim that they *can* make a product, when U.S. purchasers know full well that the mills are either unable or unwilling to meet the rigorous quality standards offered by Japanese mills, especially given small quantity requirements. In such cases, we have demonstrated – whenever possible – that domestic product cannot substitute for Japanese imports. Alternatively, customers have told the Commission and the TPSC, in briefing and in meetings, that the domestic industry imposes minimum quantity requirements to sell such specialized products. The customers purchase far less than the required minimum and therefore are dependent on imports.

Furthermore, while we have tried to respond to the domestic industry's concerns about various exclusion requests, some domestic mills that oppose a request have been unwilling to tell customers the identity of the domestic mill or mills they claim make (or "can" make) the products for which exclusion has been sought. Domestic mills have chosen to treat as business proprietary information the identity of these mills. If the domestic mills hope to gain the business of the customers who to date have not been able to obtain their steel materials in the United States, they must make themselves known so that the customers can determine whether, in fact, the mills are capable of making the product. We understand that the USTR instructed the domestic industry to reveal publicly the names of possible U.S. suppliers by January 16, 2002. Once we receive this information, we will work with customers to address the industry's opposition.

The exclusion requests purchasers have submitted to the USTR are by no means exhaustive, as innumerable small and medium sized U.S. manufacturers have long depended on high grade products from Japanese mills, unavailable from domestic producers in commercial quantities or quality. These smaller purchasers have been dissuaded from submitting exclusion requests by pressure from their domestic suppliers of more prosaic steel products. The President

should nevertheless take the interests of these manufacturers into account when crafting a remedy, by proactively excluding all products unavailable from domestic producers.[70]

Finally, the President should not adopt the standard proposed by the domestic industry of denying an exclusion request if a single domestic producer claims it is capable of producing the product concerned. It is unreasonable to expect customers to rely on a single supplier. As one customer explained to the TPSC, supply disruptions can occur at any time.[71] Automobile manufacturers recognize this, often requiring their suppliers to have more than one source for necessary raw materials. In addition, not all U.S. mills are qualified to supply specialized products. Unfettered access to imports, therefore, is a necessity in many cases.

VII. RESPONSES TO TPSC QUESTIONS

The TPSC posed three questions to Japanese respondents at the meeting on Monday, January 7, 2002: 1) Is it legally permissible to establish quota levels below the average import level of the most recent, representative three year period; 2) What is the Japanese government's view on a quota remedy; and 3) Is there any information or argumentation in Japan's submission to the USTR that was not before the ITC? We answer each below.

First, the President is constrained by U.S. law and international obligations from imposing a pure-quota remedy that would be immediately binding, due to weak steel demand and low import volumes. By statute, a quota remedy may not reduce import quantity to below the average level over the most recent, representative three year period, unless the President can provide a clear justification for a different quantity.[72] This provision reflects U.S. obligations under the WTO Agreement on Safeguards almost verbatim.[73] The President has no clear justification to diverge from a quota based on the average import level over the 1998-2000 period, given that this level of imports is 23 percent <u>below</u> peak import levels over the period of investigation, and includes two years of declining import volume.[74] Even if he did, there is no

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70 For a summary of these products, see Exhibit 6 of the *Japanese Respondents' Comments on the Remedy Recommendation of the U.S. International Trade Commission for Carbon and Alloy Flat-Rolled Steel Products, supra.*

71 Statement of Jeff Reilly, Vice President of Procurement, Gibbs Steel and Wire, before the TPSC (Jan. 11, 2002).

72 19 U.S.C. §2253(e)(4) ("Any action taken under this section proclaiming a quantitative restriction shall permit the importation of a quantity or value of the article which is not less than the average quantity or value of such article entered into the United States in the most recent 3 years that are representative of imports of such article and for which data are available, unless the President finds that the importation of a different quantity or value is clearly justified in order to prevent or remedy the serious injury.").

73 WTO Agreement on Safeguards, Article 5.1 ("If a quantitative restriction is used, such a measure shall not reduce the quantity of imports below the level of a recent period which shall be the average level of imports in the last three representative years for which statistics are available, unless clear justification is given that a different level is necessary to prevent or remedy serious injury.").

74 *See* Japanese Respondents' Comments on the Remedy Recommendation of the U.S. International Trade Commission for Carbon and Alloy Flat-Rolled Steel Products, Jan. 4, 2002, at 7.

other recent three year period that would result in binding quotas in the short run, though the reason -- low import levels -- argues compellingly for no import restraints at all. [75]

More restrictive quotas are legally permissible only under a tariff-rate quota ("TRQ") remedy. Because a tariff-rate quota is not a quantitative restriction -- out-of-quota imports are merely subject to a tariff -- tariff-rate quota baseline levels are not limited by U.S. law or international obligations.[76] The President could therefore impose a tariff-rate quota baseline that is lower than the baseline possible under a quota remedy.

However possible from a legal standpoint, the imposition of an out-of-quota tariff as high as the tariffs proposed by the ITC and domestic producers would essentially transform a TRQ into a quantitative restriction. Such a high out-of-quota tariff would be gratuitous, given that the quota component of a tariff-rate quota would itself act to increase import prices, as foreign producers seek to fill their tariff-free quota allocations with their highest-value products. Though a tariff-rate quota remedy would not be as import-preclusive as a tariff remedy during the current recession, an out-of-quota tariff set too high could quickly become import-preclusive when demand recovers, wreaking just as much damage on steel consuming industries.

Second, the Japanese Government fully agrees with the remedy recommended by the Japanese industry. The Japanese Government believes that the ITC injury finding is wrong and does not comply with WTO rules. But if the President decides to impose import relief, the Japanese Government believes that quotas would be the most preferable remedy when compared with tariffs. In addition, the Japanese Government believes that any quotas must be country-specific and must reflect import levels of the 1998 to 2000 period.

Finally, virtually all of the arguments made in the Japanese Respondents' January 4, 2002 submission to the USTR, commenting on the ITC's remedy recommendations, were also made to the ITC over the course of its investigation, through briefs and testimony. The only exceptions are in response to developments subsequent to the Japanese Respondents' final submission to the ITC on November 13, 2001, including the Commission's specific injury and remedy findings. Exhibit 6 summarizes these developments, and how they are reflected in the Japanese Respondents' original submission to the USTR. In this reply submission, the economic analysis of an anti-surge quota remedy versus a 20 percent tariff remedy over a three year

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75 Commissioner Okun made no more than a perfunctory effort to justify her departure from the most recent representative three year period in basing her quota baseline period on the 1996-1997, 2H00-1H01 period. *See* ITC determination, at 453 (noting that the 1998-2000 period includes the "surge" year 1998). Nevertheless, Commissioner Okun's proposed quota remedy is preferable to the tariff remedies recommended by her colleagues. A baseline quota below the 1998-2000 average would be legally permissible if accompanied by a "clear justification".

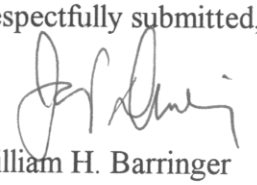
76 *See United States - Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/R, October 29, 2001, at para. 7.69 ("We do not consider that tariff-rate quotas are 'quantitative restrictions' within the meaning of Article 5. We note that the second sentence of Article 5.1 refers to quantitative restrictions in the sense of measures that 'reduce the quantity of imports below {a certain} level'. Tariff quotas do not necessarily reduce the volume of imports below any predetermined level... .").

remedy period contained in section I above differs from the economic analysis presented to the ITC, which compared the two remedies using a one-year "snapshot" -- the same approach taken by all other parties.

CONCLUSION

For the foregoing reasons, the President should impose no remedy on finished flat-rolled steel products or at most, impose an anti-surge quota with a baseline predicated upon average import volume over the 1998-2000 period, conditioned on the rationalization of excess domestic capacity.

Respectfully submitted,



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